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Economic Conditions Governmental Finance United States Securities

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General Business Conditions

THE overwhelming Allied victories of the past month leave little doubt that the end of the European war is in sight, and that the struggle is being prolonged chiefly by the desperation of the Nazi leaders and their futile hope that if they will hold on events will somehow turn in their favor, permitting them to make an "easy" peace. To this end they are sacrificing the manpower and resources of their country, and bringing upon it a far greater destruction and loss than it is now capable of inflicting. How long their senseless policy will prevail can hardly be foreseen, but what the end will be is apparent, for the German armies are steadily being broken, their communications cut and their material destroyed.

It seems correct to say that the German forces in the West are now more thoroughly defeated than they were in the Fall of 1918. Then their front was unbroken and their communications intact. The Allied commanders expected them to make a fighting retreat to the Rhine and put up a strong defense there, and were preparing major offensives for 1919. But Germany did not choose to spend her strength on a hopeless defense. Now the question is how long she can defend herself if she wishes. The Allied generals are confident that the bulk of the German armies will never get back to the Rhine as a fighting force. If they do not the defense of Germany for any length of time will be impossible.

In the East the Germans cannot possibly restore the breach opened in "fortress Europe" by Russia's victories, Rumania's turnabout and Bulgaria's defection. At a stroke the battle line has moved to the Hungarian frontier and probably it will move soon to the Austrian frontier. Meanwhile Russian pressure in Poland and the Baltic States continues and new offensives there are almost certainly being organized. In Italy the German line is outflanked by the Allied conquest of Southeastern France.

Our forces are bearing nobly their part in these great battles. The achievements of the American armies in France will stand in history

as supreme examples of military boldness, vigor and skill, all resting in last analysis upon the courage and devotion of commanders and men at the front, supported by the flood of weapons poured out by the workers at home. The interest of the country is overwhelmingly centered in their progress. Mingled with the feelings of thankfulness for approaching victory, and of sorrow and reverence for the fallen, are feelings of gratification over the way American troops have acquitted themselves. Nothing less was expected, but the country is proud that representative American youths have overcome the best Germany can offer.

Waiting for the End

From now until the war's end the country will be waiting, and meantime making what preparations and adjustments it can without relaxing in the work and effort still needed. To many people the country appears to be approaching reconversion problems in a deplorable state of confusion. The military viewpoint is that too much emphasis is being placed too early upon reconversion, and that the war effort is being hampered by failure to concentrate sufficiently upon production of military items that are still urgently wanted. On the other hand, a strong body of opinion holds that postwar programs are subject to far too much delay and controversy, and that the country will pay a penalty of unnecessary depression and unemployment for not being forehanded.

While there is plainly an excess of confusion, controversy and delay, it is possible that the situation is not as bad in either respect as the extreme critics charge, and that it will be brought into better shape, before time runs out, than they are now ready to believe. The opinion expressed by some military officials, that reconversion is holding back war production, rests chiefly upon statements that labor is leaving war plants for more lasting jobs. Where this is the case, however, it is unlikely to be stopped by suppressing discussion of reconversion; for it is not this discussion, but the progress of the armies, which

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leads people to expect early victory. The real question is whether actual increases in civilian production are being permitted at the expense of the war effort. Little concrete evidence to that effect is offered. All the War Production Board's orders designed to facilitate reconversion are safeguarded to assure against withdrawing labor from war production, with the War Manpower Commission having the last word; and the evident fact that very little reconversion is taking place or is at present possible under these orders is the answer to the fears of those who opposed them.

In the overwhelming majority of war items it is clear that production is up to requirements, and that stocks in most cases are abundant. Two economists of the W.P.B. resigned last month because of refusal of higher authorities to give publicity to figures showing military inventories at levels which they believed were large enough to justify further cutbacks. Testimony, however, has been offered that output of certain items is behind schedule and below needs. The causes of this are various. Some of the programs have been so recently expanded, due to changing requirements and rapid progress of the war, that there has not been time for production to catch up. Others are due to difficulties in maintaining the labor supply and labor efficiency at all the points where bottlenecks exist, and to excessive turnover and absenteeism, which have plagued the war effort throughout and which doubtless have been increased by the hot weather.

These items are the exceptions. If their production can be speeded by withholding permission to resume civilian goods manufacture the regional officials of W.P.B. and W.M.C., who should best know the facts, have the necessary authority and may be relied upon to act in the interests of the war effort.

Progress in Government Programs

If comparison is made between the state of postwar preparations now and at the corresponding stage of the first World War, it is all in favor of the present—as it should be, considering the lessons of experience and the greater magnitude of current problems. When the Armistice came in 1918, it had been expected for only a few days or weeks, and little or nothing had been done toward establishing principles or procedures to deal with transition questions. The difficulties of contract termination and settlement of claims had been little considered, virtually no thought had been given to disposition of surplus property, and even the demobilization of the armed forces had received only preliminary study. Controls over prices, business and labor were fewer, simpler, and incomparably less far-reaching.

For this war excellent legislation to govern settlement of claims on terminated contracts

has been passed. Whether the administrative handling of terminations will be as excellent as the legislation of course remains to be demonstrated, but the pattern laid down has won general commendation. Congress is well-advanced in its consideration of surplus property disposal and of overall demobilization problems; a good bill covering the former has passed the House and bills covering the latter have passed both the Senate and the House. Many proposals have been considered, and many that were inadvisable or unsound have been rejected.

While the final form of these bills is uncertain, and lack of space prevents discussion in detail, mention should be made of sound provisions in the "War Mobilization and Reconversion Act of 1944" (S. 2051) as passed by the Senate and approved by the House with some changes. It provides that war production shall not continue "merely for the purpose of providing business and employment." It provides that non-war production shall be permitted whenever it does not interfere with production for war purposes, regardless of whether some competitors are free from war production before others, and regardless of the previous position of producers in the industry. Of course it is desirable as far as possible to treat competitors equally; hence the latter provision will not be welcome to everyone. However, there are sound reasons for it. It puts the national interest in employment and production above competitive interests. If people are to have jobs, scarcities of goods are to be eliminated, and the inflationary menace defeated, this is where the emphasis belongs.

Likewise the unemployment compensation provisions of S. 2051 represent a smaller charge on the Treasury and on the economic system as a whole than was provided in the rival Murray-Kilgore proposals, which were defeated. Senators Murray and Kilgore both made pleas for higher compensation, on ground described in the debate by Senator Murray as follows:

Mr. President, there are those who have charged that the unemployment compensation features of this bill are wildly extravagant. They fail to realize that the purpose of the unemployment compensation provisions is not to provide relief but to stimulate purchasing power and employment.

The two Senators argued that higher unemployment compensation would cost less because if it were paid there would be less unemployment, but Senator Ferguson disposed of this argument by suggesting in effect that a still higher rate be paid so that there would be no cost at all. The Senate as a whole in defeating the proposals evidently was moved by the consideration that the benefits granted would make unemployment too attractive, by the charge on the Treasury, and by the inflationary danger, and rejected the argument

that continuous government spending would keep the country prosperous. The bill as passed will provide unemployment compensation on a scale determined by reference to needs, local standards, and ability to pay rather than by the spending philosophy.

In all these matters the Baruch-Hancock report of last February—for which there was no equivalent in the last war—is proving of inestimable benefit, and the influence of the sound principles it laid down is felt everywhere. The authors of the report were moved last May to sound their call of "Hurry, hurry," which should have been heeded sooner, but Congress has now made these measures practically its sole business, and the country will soon know what principles and procedures it must adjust itself to.

Reconversion Policies

Also, business men have more to go on than they had a month ago in judging what to expect both before and after the end of the European war, — provided, to be sure, that changes in W.P.B. administration do not alter the policies which now seem to be evolving. The order of August 15, permitting local resumption of manufacture of essential civilian goods where there will be no interference with the war effort, will be controlling until the European war ends. As already stated, this order will not lead to any substantial early increase in civilian production, but it tells manufacturers what conditions they have to comply with and it encourages and facilitates planning.

Policies to govern after the European war ends are less definite, but light has been thrown upon them by official W.P.B. statements. Mr. Nelson, the chairman, has said that war production will be curtailed by 40 per cent when the Germans surrender, and that this will clear the way for an increase of 30 per cent in civilian output. Mr. L. F. Boulware, vice-chairman in charge of operations, has followed this by saying that with from six to a dozen exceptions the "L" orders, which restrict output of certain articles, and the "M" orders, which limit use of materials in specific products, can be wiped out in a matter of hours when the time comes. The orders whose continuance will be necessary cover partly materials whose major source is in Japanese-dominated territory (tin, manila hemp, natural rubber) and partly the few in tight domestic supply (lumber, paper, some textiles and chemicals). Probably a simple priority system will be used for the benefit of war manufacturers and the Controlled Materials Plan will be reduced to a compilation of statistics.

Nothing could be more essential than the prompt elimination of these limitation orders at the same time that wholesale cancellations of war contracts go out. Many think that Mr. Nelson's estimate of 40 per cent as the prospective

cutback in war production is conservative. Even if it is no larger, the transition to a 30 per cent increase in civilian production will be slow and confused unless manufacturers are free to make their adjustments, set their plans, get ahead with their re-tooling, and obtain materials with a minimum of restraint. When war contracts are cut as indicated, raw materials with few exceptions will be in surplus supply. There will no longer be reason or excuse for limitations on their use, and the first essential reconversion policy should be to wipe out such limitations promptly.

In these decisions also the influence of the Baruch-Hancock report is plain. The report called for an early review of all materials limitations, for an early start in relaxing controls, and for elimination of all controls when no longer necessary. In some quarters there is sentiment for "controlled decontrol," or in other words, continuance of government planning and controls for a considerable time, perhaps until there is no longer any need for war goods at all and the civilian economy has been finally reestablished. Those who share this sentiment should ask themselves whether it is calculated to provide more, or less, production and employment. As materials and labor become ample, which now seems likely within a fairly short time, what function can government allocations perform that will not be restrictive? Even if there should be no intent to make them restrictive—in which case it is hard to see why they should be maintained—their very existence would give them that effect, due to the inevitable delay and red tape in their operation.

Chiefly the people who are of this view want the controls continued in the interests of "fairness" as between competitors. But the question is, how much fairer to everyone concerned, including the general public, are government allocations and decisions than the decision of a free market, open to all?

In the study of reconversion policy and transition problems the guiding question should be, who is responsible for prosperity? There is a sphere in which sound government action is required, but mostly for the purpose of protecting the ability of, and encouraging, private enterprise to go ahead. The Government cannot possibly assure genuine prosperity by providing work itself, for this leads to "made work,"—work undertaken without regard to cost or economic value. To consider that such work makes a country prosperous is as much a delusion as a belief that war makes us prosperous. The same delusion is responsible for the proposals for deficit spending. Actually the war deficits have created a debt and a credit expansion which is a menace, and the great need is to remove the menace by a return to sound fiscal policies instead of adding to it after the war.

Nor can the Government assure prosperity by assuming the direction of private enterprise. For the Government cannot *make* people go ahead and do things; it can only *direct* or *prevent* them, if they want to do things. Thus government planning and control is necessary in wartime, but by its nature it is restrictive in peacetime. This one principle is the answer to all the arguments currently being advanced for "controlled decontrol." It is the principle that should govern reconversion policies.

Postwar Tax Plans

With anticipation of the end of the war the planning ahead in taxes, as in other phases of national policy, is facing new objectives. The task is no longer one of adapting the tax system to a war economy, with its need for enormously increased revenues and restraints upon civilian spending and inflation. It becomes one of readjusting the tax system as speedily as possible to peacetime needs, with emphasis upon the kind of taxes which, while providing adequate revenue for the necessary expenditures of the Government, will afford the least impediment to enterprise and the expansion of postwar employment.

Both political parties are pledged in their platforms to lower taxes after the war. In Congress, the joint committee on internal revenue taxation of the House Ways and Means Committee and the Senate Finance Committee, in collaboration with Treasury tax experts, is engaged in a study of postwar taxation. Likewise, many private organizations are studying the problem.

Three different groups engaged in economic planning and research have recently prepared comprehensive postwar federal tax recom-

mendations, the publication of which has stimulated discussion. The first of the plans issued was prepared by Harold F. Groves, Professor of Economics at the University of Wisconsin, published under the auspices of the Committee for Economic Development in book form entitled "Production, Jobs and Taxes" (McGraw-Hill Book Co., New York, \$1.25). The second or "Twin Cities Plan" was prepared by a group of Minnesota business men as "a realistic approach to the problem of federal taxation" and was issued in pamphlet form (Twin Cities Research Bureau, 332 Cedar Street, St. Paul, Minnesota). The third was a memorandum prepared by Beardsley Ruml and H. Christian Sonne for the National Planning Association and published in pamphlet form under the title "Fiscal and Monetary Policy" (National Planning Association, 800 21st St., N.W., Washington, D. C., or 184 E. 64th St., New York, N. Y., 25c).*

The Groves plan is in the nature of a preliminary report to be followed later by one or more reports including detailed recommendations as to rates and provisions of different types of federal, state and local taxes. All three plans stress the fact that many of the proposals are necessarily tentative.

*See also pamphlet "Postwar Tax Policy and Business Expansion" by Dr. Lewis H. Kimmel, Brookings Institution, Washington, D. C. (1943, 50c), and current series of articles by Godfrey N. Nelson in the New York Times; also "Postwar Tax Plans" by Professor Harley L. Lutz of Princeton University in August 1944 issue of Tax Review, published by Tax Foundation, New York; also study of postwar budget by Professor W. L. Crum of Harvard University for the National Bureau of Economic Research, summarized in article "The Federal Budget: A Challenge to Businessmen" by John W. Welcker in Summer 1944 issue of Harvard Business Review.

COMPARISON OF THREE FEDERAL POSTWAR TAX PLANS WITH THE PRESENT LAW

	Present Law	Groves (Com. for Econ. Dev.)	Twin Cities Plan	Ruml-Sonne (Natl. Plan. Assn.)
Corporation income taxes				
Normal and surtax	40%	Repeal	40%	Repeal
Excess profits tax	95%	Repeal	Repeal	Repeal
Tax on undistributed income	None	Possibly	None	16% — New
Franchise tax	None	None	None	5% — New
Other corporation taxes				
Capital stock tax	\$1.25 per M	Repeal	Repeal	Repeal
Decl. value excess profits tax	6.6 to 13.2%	Repeal	Repeal	Repeal
Penalty tax on consol. returns	2%	Repeal	Repeal	Repeal
Dividend receipts subject to tax	15%	Repeal	Repeal	Repeal
Individual income taxes				
Exemptions — single	\$ 500	Maintain broad	\$ 600	\$ 500
Exemptions — married	1,000	base and high	1,400	1,000
Credits for dependents	500	standard rates,	400	500
Normal rate	3%	Some moderation	10%	16%
Suratx begins at	\$0 to \$2M @ 20%	in middle and	\$2M to \$4M @ 6%	\$2M to \$3M @ 1%
Suratx maximum	Over \$200M @ 91%	upper brackets,	Over \$300M @ 50%	Over \$200M @ 50%
Dividends received	Fully taxable	Fully taxable	40% exemption	Fully taxable
Interest on govt. obligations	Partially exempt	Fully taxable	?	Fully taxable
Retail sales tax				
	None	None	5% — New	None
Excise taxes				
	Various	Repeal or reduce	At 1943 rates	Tobacco, alcohol, possibly gasoline

The Three Plans Compared

As an aid in examining the specific proposals of the three plans, the main features have been brought together in the accompanying summary, which shows also the present law. Any condensed summary tends of course to oversimplify the programs, since many of the proposals are not strictly comparable and are subject to qualifying detail.

All three plans stress the importance of a postwar tax program that will give incentive to business expansion, particularly the growth of small business enterprises. The plans are unanimous in condemning the unfairness and retarding effect upon investment of the present double taxation of corporate income, first as income to the corporation and then as dividend income to the shareholder. In order to remove, or at least relieve, this discrimination against income from stock investments, there are various proposals for eliminating or drastically reducing direct taxes upon corporate income as such, but taxing the income when received as dividends by the individual shareholders. In this way, income from business will be taxed only once, and will be subject to the same graduated personal taxes that apply to income from other sources.

At the present time corporations are subject to a combined normal and surtax rate of 40 per cent, and an excess profits rate of 95 per cent. As shown in the comparative summary, the Groves plan proposes the repeal of both the excess profits tax, and the normal and surtax, with possible substitution of a normal tax on undistributed income. The Twin Cities plan would repeal the excess profits tax, but retain the normal and surtax at 40 per cent. The Ruml-Sonne plan would repeal both the excess profits tax and the normal and surtax, but substitute a new "franchise tax" of 5 per cent on net income, as well as a new tax of 16 per cent on that portion of net income not distributed.

Dividends received by shareholders would continue, as at present, to be fully taxable under both the Ruml-Sonne and the Groves plans; the latter suggests that the tax on dividends be withheld by the corporation. The Twin Cities plan, which proposes to retain the 40 per cent corporate normal tax, would exempt from taxation 40 per cent of the dividend income received by individuals.

All three plans recommend repeal of four other corporate taxes: (1) capital stock tax of \$1.25 per \$1,000; (2) declared value excess profits tax of 6.6 to 13.2 per cent; (3) penalty tax of 2 per cent on filing consolidated returns; and (4) provision in present law subjecting to tax 15 per cent of intercorporate dividend receipts.

In the proposals with respect to individual income taxes, all three plans recommend—either in general language or specific rate schedules—maintenance of a broad base and high standard rate, but some moderation from the existing high wartime rates. The Twin Cities plan proposes a new federal tax of 5 per cent on all retail sales, with no exemptions, but offers as an alternative a higher schedule of individual income tax rates in case the sales tax is not adopted. Neither of the other two plans recommends a sales tax.

Repeal or reduction of excise taxes is recommended in the Groves plan, and the Ruml-Sonne plan would repeal all excise taxes except those upon tobacco, alcohol, and possibly gasoline. The Twin Cities plan suggests, in general terms, applying the 1943 rates.

In connection with capital gains and losses, the Twin Cities plan proposes that all assets held over six months be treated as capital assets and that the rate on net capital gains be halved, with a more liberal treatment of net capital losses.

Various other tax changes recommended in one or more of the three plans—too technical and numerous for elaboration here—refer to such matters as computation of corporate excess profits tax credits, carryforward and carryback of corporate net operating loss deduction, need for more latitude in depreciation and depletion reserves, lower exemptions and improved provisions of estate taxes, integration of gift taxes with estate taxes, elimination of tax exemption upon interest from all government securities, extension of merit rating for unemployment compensation taxes, and allowance of limited deductions for postwar reserves.

Assumed Budgets and National Income

The three plans all proceed upon the assumption that the federal budget (exclusive of social security taxes, handled as trust funds) might be slashed by perhaps four-fifths from the present wartime level of expenditures—around \$94 billion in the fiscal year 1944—bringing it down to around \$18-20 billion. This would still be more than twice as large as the 1939 budget, six times the average for 1922-31, and 25 times the average before World War I. The Twin Cities plan assumes that \$18 billion of revenue needed to balance expenditures could be obtained at the rates proposed from a total national income of \$120 billion. The Ruml-Sonne plan relies on a national income of \$140 billion to produce \$18 billion of revenue at the suggested rates and would not attempt to balance the budget except when the national income is at that level. For purpose of comparison, the highest national income ever reached prior to 1941 was \$82.6 billion in 1929, and the all-time peak this

year, swollen by war expenditures, is estimated at \$153 billion.

In basing their calculations on an assumed national income so close to the war peak, the authors of the Ruml-Sonne plan reflect the thinking of the school which holds that a balanced budget is undesirable except in time of maximum business activity and full employment. This is the deficit financing theory. According to this theory, government spending in excess of receipts, if pushed vigorously enough, not only will lift the national income but carry it to a level where the revenues flowing from the higher level of national income will automatically bring the budget to a balance. That deficit spending may indeed exert a stimulating influence and produce a temporarily higher level of national income need not be questioned, but that it will produce a balanced budget is quite another matter. Certainly there is no warrant for the assumption in our experience. We tried it in the '30s and it did not work. The argument was then advanced that the trouble was we did not spend enough—"if only we had spent a lot more everything would have come out alright". But surely that argument was exploded in the '40s. Though expenditures soared to unheard-of heights, and national income and government revenues also increased (the latter with the help of steeply higher tax rates), the revenues fell further and further behind the expenditures and the deficits became bigger than ever.

Apart from national income, any assumptions as to postwar federal budgets are dependent upon whatever demands—over and above the ordinary government operating expenses and interest charges—may be made upon the Treasury in the postwar period. Already a great variety of proposals involving heavy federal expenditures have been brought forward, such as vast new super-highways and public works, an expanded social security system, grants of special benefits to service-men and to war workers, support of farm prices by subsidies, continued lend-lease, a permanent large Army and Navy, an international stabilization fund and reconstruction bank, etc.

On the basis of these different assumptions as to national income, the Twin Cities and Ruml-Sonne plans make estimates of tax revenues comparing with actual receipts in 1939 and 1944 as shown in the next table.

The Twin Cities plan would get 28 per cent of the budget from direct corporate taxes, 31 from direct individual taxes, and 41 from excise and other taxes, a distribution somewhat similar to that of 1939. The Ruml-Sonne plan calls for 19 per cent from excise and other taxes, a share somewhat similar to that of the fiscal year 1944 just closed, but only 6 per cent from direct corporate and 75 from direct individual taxes.

Comparison of Federal Revenue Receipts Assumed Under Two Postwar Tax Plans with Actual Receipts in Fiscal Years 1939 and 1944

(In Millions of Dollars)

	1939	1944	Twin Cities	Ruml-Sonne
Direct corporate				
Normal and surtax	\$1,123	\$ 5,301*	\$ 5,000	\$ —
Excess profits tax	—	9,374*	—	—
Capital stock tax	127	382*	—	—
Dec. val. e. p. tax	34	137*	—	—
Undistributed income	—	—	—	1,000
Franchise tax	—	—	—	—
Subtotal	1,284	15,194	5,000	1,000
Direct individual				
Income— withheld	—	8,455*	5,000	13,000
Income— other	1,029	11,283*	—	—
Estate and gift	361	552*	500	500
Subtotal	1,390	20,290	5,500	13,500
Excise taxes, etc.	1,751	4,462	4,000	3,000
Sales tax—5%	—	—	2,800	—
Social security—net	237	492	—	—
Customs	319	431	400	—
Misc. receipts	184	3,280	300	500
Total net receipts	\$5,165	\$44,149	\$18,000	\$18,000
Percentage distribution				
Direct corporate	25%	34%	28%	6%
Direct individual	27	46	31	75
Excise and other	48	20	41	19
Total	100	100	100	100

Total net receipts include the portion of excess profits taxes refundable after the war, but exclude the portion of social security taxes appropriated to old age insurance trust funds. *Distribution partly estimated.

The Twin Cities plan, based on a national income of \$120 billions, considers it unfeasible to raise so much of the needed \$18 billions from personal incomes, and also gives less weight to the arguments against corporate taxation than the Ruml-Sonne plan. While heavy reliance upon a direct personal tax has the advantage of simplicity and of making the public "tax-conscious," it also has serious disadvantages as compared with the employment of a variety of different taxes, in that the personal income tax fails to reach large numbers of taxpayers and falls with extreme severity upon those who do pay. Also, undue reliance upon a single tax leads to instability in government revenues.

Many Other Questions to Be Explored

In the development of the general postwar tax program, many questions must be carefully explored in deciding how whatever tax relief is possible should be distributed as between corporations and individuals. Much more information is needed on the source of "venture capital"—how much may be expected to come from corporations, large and small, and how much from individuals of the different income classes? It is agreed that business, particularly the small companies, must be given an incentive to produce and not just "play safe", but how might changes in corporate and individual taxes affect such incentives?

An important series of questions relate to who pays business taxes? In other words, to what extent do corporate income taxes tend to be passed along to the consumer in the

cost of the product, thereby representing a convenient way of collecting money from the public for the Treasury? Would corporate tax relief widen margins of profit, and induce new investment, or would it be distributed to labor in higher wages or to the consumer in lower prices? Would the proposed cuts in corporate taxes require—on the basis of a reasonable level of national income—excessively high personal taxes, or vice versa?

In addition to a postwar lowering of tax rates, would this be an opportune time for a thorough revision of our entire federal-state-local revenue system with a view to simplifying its administration and reducing, if not fully eliminating, its admitted overlappings and inequalities?

The major objectives, however, would seem to be, first, a determined effort to hold down the peacetime level of government expenditures by eliminating all nonessential outlays; and second, a lowering of tax rates with the reductions spread around where they will afford the most relief in fostering business expansion, thereby lifting the standard of living. The fifteen successive deficits during the years 1931-45 inclusive aggregate \$210 billion, while the public debt has risen from \$16 billion in 1930 to an estimated \$251 billion by June 1945. Even that will not be the top unless the budget is brought under control in 1945-46.

Finally, the principle that public debt should be paid off in good times should be established; and the new postwar budget might well include a fixed amortization item. Even though it might not be possible to retire, net of refundings, the full amount in certain years, it might be possible in good years to retire much more than the fixed amount. Last month Mr. Daniel W. Bell, Acting Secretary of the Treasury, stated that it will be desirable after the termination of the war to adopt an overall policy with respect to debt reduction, and in due course the Treasury would recommend to Congress general legislation with respect to this subject.

The Bretton Woods Agreements

That some kind of international program is needed in dealing with postwar currency and credit is generally accepted, and a vast amount of thinking and planning has been done in this field. The American and British Treasuries took the lead over a year ago in publishing the White and Keynes plans for postwar currency stabilization, and last Fall the American Treasury announced its tentative program for a United Nations Bank for Reconstruction and Development to function in the field of long-term credit. These moves stimulated widespread discussion and brought suggestions from many sources. In April this year came

the joint statement of principles by the financial technicians of the various United Nations governments, covering an International Monetary Fund to deal with the currency stabilization problem.

This joint statement of principles, together with the U. S. Treasury experts' plan for a World Bank for long-term credit, formed the agenda for the Bretton Woods Conference. It was the first full-dress official conference on these matters, and the conclusions reached constitute the first series of definite proposals coming before the various governments for action. While this is an important step, the plans are still far from adoption. They must still negotiate the hurdle of criticism and ratification by the home governments; and with us this, of course, includes Congress. It is well to bear in mind that the Conference itself was by no means in full accord on all points of the program. Most, if not all, of the delegations made reservations to the "agreements", and because of these differences it was agreed that the delegates would submit the plans to their governments without recommendations, either for or against.

As regards public appraisal of the Conference proposals, the plain truth is that very few people understand them. Though the official texts have been published in full, they are so voluminous and the language so involved and technical as to make extremely difficult reading even for those who know something of the subject, not to speak of the average person untrained in these matters. The first step, therefore, in reviewing the Conference would seem to be to get a picture of some of the main things it did.

Such an attempt may well begin by dividing the Conference results into three parts — (1) the general resolutions, (2) the proposed International Bank for Reconstruction and Development, and (3) the proposed International Monetary Fund.

General Resolutions of the Conference

First, as to the general resolutions. While some of these are of a technical nature and can be passed over here, others ought to be mentioned.

One of the resolutions, dealing with international economic problems, contains the important declaration that the purposes and objectives of the International Monetary Fund "cannot be achieved through the instrumentality of the Fund alone". Governments, in addition to implementing the particular monetary and financial measures which were the subject of the conference, are urged to seek the creation in the field of international economic relations of "conditions necessary for the attainment of the purposes of the Fund".

More specifically, it is recommended that governments try to reach agreement as soon as possible on ways whereby they may best:

(1) Reduce obstacles to international trade and in other ways promote mutually advantageous international commercial relations; (2) bring about the orderly marketing of staple commodities at prices fair to the producer and consumer alike; (3) deal with the special problems of international concern which will arise from the cessation of production for war purposes; and (4) facilitate by cooperative effort the harmonization of national policies of member states designed to promote and maintain high levels of employment and progressively rising standards of living.

In other words, the Conference recognizes that currency stability is not a matter of monetary mechanisms alone, but depends upon actions and policies in other directions as well.

Other resolutions deal with enemy assets and looted property and include the recommendation that the Bank for International Settlements be liquidated "at the earliest possible moment". The Conference resisted pressure for "doing something for silver", suggesting that the subject be given further study by the interested nations.

Action on the International Bank

Of the proposals covering the two new international financial institutions, those for the Bank may be considered first, both for the reason that they have had less public discussion, and because they are simpler and more understandable.

Planning all along has been less advanced on the Bank than on the Fund, and while the U. S. Treasury — as already noted — had sponsored a tentative plan last Fall, there was no joint experts' agreement preliminary to Bretton Woods in the case of the Bank as there had been in the case of the Fund. Indeed, there was some uncertainty prior to Bretton Woods as to how far the Conference would get in considering the Bank plan at all. In view of the fact that the Bank has been so much in the background up to now, a brief sketch of its principal features seems in order:

Purposes: The purposes of the Bank are set forth in the articles of agreement as follows:

1. To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.

2. To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.

3. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories.

4. To arrange the loans made or guaranteed by it in relation to international loans through other channels, so that the more useful and urgent projects, large and small alike, will be dealt with first.

5. To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

Membership and capital: As a means of attaining the above broad objectives, the Bank would have an authorized capital of \$10 billion, of which \$9.1 billion would be initially subscribed by the 44 United Nations meeting at Bretton Woods. Of the latter total, the United States' share would be \$3,175 million, or approximately 35 per cent. That of Great Britain would be \$1,300 million; Russia \$1,200 million; China \$600 million; and France \$450 million.

Not all of this money, however, would be wanted immediately. Initial payments of each member country would be limited to 20 per cent, of which 2 per cent would be in gold or U. S. dollars and 18 per cent in local currency (with provision for deferment of gold contributions in cases of devastated countries or countries whose gold reserves have been seized or immobilized as a result of the war). The initial payment of the United States would therefore be \$635 million. The balance of 80 per cent would be reserved in the form of unpaid subscriptions as a surety fund for the securities guaranteed by the Bank, and would be called only as needed to cover defaults on such issues.

Management and voting power: Management of the Bank would be vested in a governing board representative of each member country, and meeting annually with such additional meetings as may be provided for by the board or called by the executive directors. The latter would be a body of twelve in continuous session, 5 members to be appointed by the countries having the largest quotas — The United States, Great Britain, Russia, China, and France — and the others elected under a system of proportionate representation. The executive directors would be responsible for the active conduct of the Bank, and would appoint a president as the principal operating officer.

Voting power would be on the basis of 250 votes for each country plus one vote for every \$100,000 of that country's subscription. Thus the United States would cast about 31 per cent of the total votes, a larger proportion than any other country, but a smaller proportion than its 35 per cent share of the Bank's capital. Ex-

cept as otherwise provided, decisions would be by majority vote, but on certain specified questions the margins required would run as high as 75-80 per cent, hence giving the United States a clear veto power in such cases.

Loans and guarantees: On the all-important question of credits, the first thing to be noted is that the total of loans, participations and guarantees would be limited at all times to a maximum of 100 per cent of the Bank's unimpaired capital, surplus, and reserves. In this respect, conservative counsels prevailed in the Conference, for earlier proposals were much more liberal. The original U. S. Treasury preliminary draft outline published last Fall contained no mention of maximum limitation on credit operations, and some of the ideas pressed at the conference are reported to have run to several times the Bank's capital funds.

The articles of agreement stipulate that the Bank, before guaranteeing or making loans, must satisfy itself in each particular case that the borrower would otherwise be unable to obtain the loan at "reasonable" terms elsewhere. While the Bank would be in a position to influence interest rates, the theory at least is that it would operate only in borderline cases where the risks are too great to hold much attraction for private capital alone. Eighty per cent of the Bank's capital would be used to guarantee credits that presumably would pass through the regular banking and investment channels, with the Bank's own direct loans limited to 20 per cent.

Credits could be extended to member governments or to private enterprises in member countries, but would have to be for specific projects of reconstruction and development such as would increase the productivity of the country. They would require the written approval of a "competent committee", rendered after "careful study of the merits of the proposal". They would be fully guaranteed by the government, central bank, or other comparable agency of the country where the project is located. Of particular interest is the following: "In making or guaranteeing a loan, the Bank shall pay due regard to the prospects that the borrower . . . will be in a position to meet its obligation under the loan" (italics ours) — an admonishment noticeably lacking in the case of the Fund.

Inasmuch as most of the credits — at least in the early postwar period — are likely to be floated in the United States; it is worthy of note that *no such credits could be floated in any country without approval of that country's representative at the bank.*

All countries would share proportionately in the risks incurred by the Bank, and in case of default by any borrower on obligations guaranteed by the Bank would be expected to make good out of the unpaid share of their

capital subscription either in gold, U. S. dollars, or the currency in which the obligation was incurred. In other words, member countries have to put up the kind of money that will really discharge the Bank's obligation.

Commissions and interest: The Bank would charge a commission of not less than 1 per cent nor more than 1½ per cent per annum for loan guarantees during the first ten years of operation, but thereafter, at the discretion of the Bank, the rate could be increased or decreased. Interest rates for direct loans would be at discretion of the management.

Other provisions: The plan would become effective on ratification by nations representing 65 per cent of the subscriptions, but not before May 1, 1945. Members could withdraw from the Bank by giving notice, but would remain liable for any of their direct or contingent liabilities outstanding with the Bank at the time of withdrawal.

Bank Plan Safeguarded

All in all, the foregoing summary would indicate that the conference, in drafting the Bank plan, has moved along fairly conservative lines. This is particularly true with respect to the trimming down of the more ambitious proposals for the Bank's lending power in relation to capital, and also in the various provisions inserted in the effort to safeguard individual credits.

The plan has the advantage of simplicity, and in its use of the guarantee feature adopts a form of procedure in international lending made familiar by our Export-Import Bank. A somewhat similar plan was applied on a broader international scale in connection with certain loans issued under the auspices of the League of Nations in the '20s and '30s.

One overall question that arises is whether the sum of \$10 billion capital is not larger than necessary, considering both the large volume of gold and foreign exchange now held by many countries and available for immediate postwar needs, and also the fact that some countries should be able to borrow on their own credit without guarantee. Bearing in mind that the Bank would not be expected to intervene except in borderline cases, the query posed by the London "Economist" seems pertinent: how many loans are there likely to be which are safe enough to meet the Bank's standards and yet not safe enough to float on their own merits? There will be more such loans needed in the confusion and uncertainty of the immediate postwar period than later on.

Then there is the question as to whether it would not be better for this country to do its own foreign lending without other countries having a say in the matter and with this country in a better position to benefit from the trade flowing from such operations. This, of

course, could still be done in the case of loans good enough to attract private capital alone and loans by the Export-Import Bank. But in many situations of concern to a number of countries there is much to be said for a soundly conceived scheme for sharing such risks.

The fact that none of the loans issued or guaranteed by the Bank could be placed in this market without approval of the U. S. representative on the Bank directorate would afford this country a considerable measure of protection. Congress might find it possible to strengthen this protection by certain requirements as to appointment and qualifications of such representative, and in fact instruct this representative as to the reports he should make and even limit the amount of dollar loans he could approve in any given period.

Certainly these and all other matters pertaining to the plan will need to be weighed most carefully by Congress.

The International Monetary Fund

In its action on the International Monetary Fund, intended for postwar currency stabilization, the Conference kept to the essential structure of the experts' report which was discussed in earlier issues of this Letter. There would be set up an International Fund of \$8.8 billion, consisting of gold and currencies, of which the United States would be expected to subscribe \$2,750 million. Countries running behind in their balances of payments and experiencing foreign exchange difficulties would be enabled to borrow (though the word "borrow" is not used in the plan) other currencies from the Fund, but such borrowings would be intended only for short-run purposes and until such time as the payments might be restored to balance.

Member countries, under the plan, would agree to consult with the Fund in fixing their exchange rates, and once fixed such rates could not be changed except under conditions laid down in the Fund agreement. Member countries would also agree after a transitional period of several years to remove exchange controls as to payments on current international account, and not to impose exchange controls or engage in discriminatory exchange practices except as approved by the Fund or as otherwise provided in the agreement.

In adopting the general framework of the experts' plan, the Conference did, however, introduce a number of changes designed evidently to meet criticism that the Fund, as proposed, would make borrowing and changes of exchange rates too easy.

The criticism, for example, that earlier drafts made no provision for an interest charge on borrowing was met by introduction of a scale of interest charges graduated both as to duration and volume of borrowing. This

would be in addition to a flat "service" charge on all borrowing of $\frac{3}{4}$ per cent, which the Fund at its discretion could increase to 1 per cent or lower to $\frac{1}{2}$ per cent. Under the graduated scale, which would apply only to net borrowing (e.g. borrowing in excess of a member's gold subscription), a country could borrow net up to 25 per cent of its quota without interest for three months, after which it would pay $\frac{1}{2}$ per cent for the next nine months, and a $\frac{1}{2}$ per cent step-up each year thereafter. On net borrowing between 25 and 50 per cent of quota the country would pay an additional $\frac{1}{2}$ per cent for the first year, with a further $\frac{1}{2}$ per cent increment each successive year; and so on up the scale. On the rate reaching 4 per cent the country would be required to consult with the Fund on ways in which the borrowing might be reduced; and on its reaching 5 per cent the Fund — failing agreement with the country — could charge any rate it deems appropriate.

The higher rates, of course, would apply only after a substantial period and to a comparatively small portion of the borrowings. Thus, in the fifth year after net borrowings begin the average rate paid by a borrower would be only $2\frac{1}{2}$ per cent, assuming that the borrowing country had exercised its full borrowing rights and exhausted its quota in four years. In the eighth year the average rate would be 4 per cent, and in the tenth year, 5 per cent (exclusive of the service charge).

Another change introduced by the Conference had to do with sliding scale voting. That is, countries whose currency was being borrowed from the Fund would get an additional vote for each \$400,000 of their currency borrowed, while countries doing the borrowing would suffer a corresponding decrease in voting power. On this basis, the United States might have its voting power increased from 28 to 35 per cent, assuming the Fund's supply of dollars was being fully exhausted.

Still a third change tightened up somewhat the provision of earlier drafts relating to removal of exchange restrictions on current international payments. Under the experts' plan countries still retaining such restrictions after a transitional period of three years would have been required to "consult with the Fund", but final decision as to their retention or abandonment apparently would have rested with the country and not with the Fund. Under the plan, as amended by the Conference, the transitional period would be extended to five years, but at the end of that time the Fund could require the country to remove the restrictions under penalty of being denied access to the resources of the Fund.

A fourth noteworthy change inserted by the Conference concerned the right of countries to alter their exchange rates. The orig-

inal experts' plan had been severely criticized in this country as apparently throwing the door wide open to currency changes. In the new draft the conditions under which countries may change their currency parities are made somewhat more specific. Moreover, if a country changes the par of its currency over the Fund's objections in cases where the Fund considers itself entitled to object, the Fund would be empowered to suspend the nation from using the Fund and might eventually expel the recalcitrant member permanently.

Major Questions Still Unanswered

Such changes are in the direction of safeguarding the creditor countries, and as such will doubtless be looked upon in this country as all to the good, with the only question as to whether they go far enough. The general structure of the plan — with its system of quotas and rights to start borrowing without question of credit worthiness from a large general fund, which has been so widely criticized — remains unchanged. There is still the objection that the plan places too much emphasis upon the financial and credit machinery of stabilization and too little on the underlying essentials of sound internal economies and liberal trade policies.

Looking at the proposed changes from the standpoint of countries anticipating a debtor position gives, of course, quite a different slant. Thus, the London "Economist" — referring obviously to the proposed graduated interest rate on borrowing — calls attention to "some new provisions for putting increased pressure on the chronic deficit country by taxing it upon the use it makes of the Fund in excess of its quota", and observes regarding this and certain other alterations that "it must be said, in candour, that they are not improvements".

All of which only makes clearer the major dilemma in which the scheme finds itself. The creditor countries — and particularly the United States, which would have to put up one-half to two-thirds of the internationally valid money — naturally are concerned about having adequate safeguards against abuse of the Fund. Moreover, in return for the money they put up they would like to see real commitments made as to maintenance of exchange stability and abandonment of exchange restrictions.

The debtor countries, on the other hand, are worried about their future position. They don't know how well they are going to be able to handle their problems, hence are interested in having credit as abundant and easy to get as possible and in retaining plenty of leeway in matters of currency policy. One of the less edifying features of the Conference was the bickering over quotas by countries wanting a larger share in the Fund which

measures the right to borrow, but a smaller share in the Bank which measures the sharing of risks.

Both the debtor and creditor viewpoints are entirely logical and understandable, given the circumstances, and the countries concerned do well to ponder the obligations they are asked to assume under a plan that seeks to anticipate the future so definitely and so far ahead. This is particularly true when it is considered how much that is vital to postwar currency stability is either not covered in the plan at all, or only inadequately.

The outstanding and basic international economic problem not covered by these plans is the reconstitution of the British monetary and trade position. This is a necessary prerequisite not only to stability of the pound and reestablishment of free clearings with the sterling area, but to stability in wider areas in which the British pound and British trade have had vast influence. For five years Great Britain has poured out her wealth and treasure in prosecuting the war, divesting herself of foreign assets built up over more than a century of foreign investment and accumulating instead a huge foreign war debt in the form of short-term liabilities which are a constant overhanging threat to her currency. The solution of Britain's problem is not to be found under either the plan for the Bank or that for the Fund; yet what would be the reaction in this country if — after pledging \$1.3 billion for UNRRA, \$2,750 million to the International Monetary Fund, and \$3,175 million to the International Bank — people are told that this key situation, which lies at the heart of the postwar currency problem, has still to be taken care of.

Then there are the many non-monetary aspects of currency stabilization, including especially the matter of commercial policy stressed in the Conference resolutions as one of the subjects upon which agreement was essential to attainment of the purposes of the Monetary Fund. Sponsors of the monetary agreement have repeatedly emphasized that it was but one step in a broad international program, but that step is so important and so contingent upon the success of other steps that logically come first that those who are charged with responsibility for ratification are entitled to ask for a clearer view of the whole program.

The general agreement to postpone action on these matters until after the elections in this country serves the double purpose of keeping discussion free from political controversy and also providing an opportunity to clarify other aspects of the postwar economic program before taking action upon this part of it.

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